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ZNR UUUUU ZZH  
R 290611Z JAN 07  
FM AMEMBASSY TOKYO  
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UNCLAS SECTION 01 OF 07 TOKYO 000385

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E.O. 12958: N/A  
TAGS: [ETRD](#) [ECON](#) [JA](#) [ZO](#) [EAGR](#)  
SUBJECT: The Japan Economic Scope - January 25, 2007

Sensitive but unclassified. Please protect accordingly.

11. (SBU) Table of Contents

- 13. Keidanren Tells Ambassador Position on M&A "Misunderstood"
- 14. Kansai Association of Corporate Executives: Support for Agriculture Reforms, Abe's Survivability
- 15. Keidanren Hasn't Given Up on Doha
- 16. U.S.-Japan Reg Reform Talks Commence
- 17. Financial Services Working Group Meets in Tokyo
- 18. FTAs: Private Sector Interest: Joint Statement Calls for EPA Discussion
- 19. Japan-Swiss Report Calling for FTA Issued
- 110. Reform: CPRR Members Hopeful; Abe's Press Treatment
- 111. House of Councilors' Member Hayashi on Reform and Leadership
- 112. Japanese M&A Surge; Most Domestic Deals
- 113. Ag: U.S. Beef Imports to Japan Remain Low
- 114. New Barriers to Trade Being Erected?
- 115. Energy: Joint Seminar Examines Asia Pacific Energy Security
- 116. Business: Keidanren Leadership Reshuffle
- 117. Osaka Prefecture to Provide Japan's First SME Tax Incentives
- 118. Civair: Israeli FM Discussed Tel Aviv Tokyo Flights
- 119. MLIT's Airports Discussion Group Members Express Need for More Meetings
- 120. New Study Group to Promote KIX U.S. Routes
- 121. Regional Airports in Western Japan Focus on Profit and Shed Low-Demand Routes
- 122. Basic Industries: Japanese Diemakers Look to Expand Abroad

12. (U) This cable contains the Japan Economic Scope from January 19, 2007.

13. (SBU) Keidanren Tells Ambassador Position on M&A "Misunderstood"

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At a January 23 lunch hosted by Keidanren Chairman Fujio Mitarai, the Ambassador expressed the United States' disappointment at Keidanren's very public lobbying against proposed new triangular merger rules and warned it was inconsistent with the business group's position favoring a bilateral FTA.

Mitarai responded that Keidanren's position on triangular mergers had been "misrepresented" both in the editorials in the Nikkei newspaper as well as public and private comments from METI.

Mitarai promised to set up a briefing for the Ambassador to explain Keidanren's real views. A hint of those views came in comments by Keidanren Vice Chairman Miyahara at the same event who described Japanese companies as "weak" and "vulnerable" to hostile take over bids in comparison to U.S. and European firms. For a full report on the Ambassador's lunch see Tokyo 0368.

14. (SBU) Kansai Association of Corporate Executives: Support for Agriculture Reforms, Abe's Survivability

At a recent dinner with Osaka-Kobe Consul General Danny Russel, Co-Chair of the Kansai Association of Corporate Executives (Kansai Keizai Doyukai) Atsushi Kojima again showed himself to be a strong advocate of agricultural liberalization.

He repeated his belief that a handful of farmers are locking up Japan's agricultural sector to the detriment of public/national interest. Beyond the unsustainability of farming demographics and the high cost to consumers, he argues that the demanding Japanese palate will support the domestic niche market for certain uniquely Japanese items (so there is no need for import barriers) and that Japanese agriculture can be competitive in producing/exporting certain high-end products.

Although personally he favors developing a scheme to promote imported labor in Japan, his Doyukai colleagues are not ready to support changes to Japan's immigration system yet.

Kojima said that he and other business leaders are worried about Prime Minister Abe's survivability. Lately, people commonly ask one another "is he going to make it?"

Kojima said the business community in Osaka needs to back the government and he -- as well as Doyukai -- is determined to support Abe.

He clearly was very pleased with Abe's perceived responsiveness to Kansai Doyukai's recommendations on economic policy issues, praising Abe for making adjustments to GOJ policy based on Osaka's input.

He said Abe was an ineffective communicator and that was not likely to change -- attributing it to his regional background.

#### 15. (U) Keidanren Hasn't Given Up on Doha

TOKYO 00000385 002 OF 007

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With the Davos meeting of world economic leaders set to start, the Japan Business Federation (Keidanren) joined with several non-Japanese business organizations to call on WTO members to redouble efforts to reach an agreement on the Doha Round of multilateral trade talks.

The joint statement was drafted under the leadership of the American Chamber of Commerce to the European Union, together with other business organizations from the United States, European Union, Australia, Canada, Hong Kong, Brazil, Taiwan, South Korea and India.

It urges WTO members to jump start the Round and achieve agreements on core elements within the next 2-3 months.

The business organizations suggest that if the round fails it could lead to increased regionalism and protectionism.

A Keidanren official told us that, compared to a similar statement issued in July 2006, this one enjoyed wider support, with more organizations signing on. She added that the joint statement is more balanced and ambitious, covering core sectors such as industrial goods, agriculture, services, trade facilitation, and development.

The U.S. business organizations included the Coalition of Service Industries (CSI), National Foreign Trade Council (NFTC), the United States Council for International Business (USCIB), and the American Chamber of Commerce to the European Union.

#### 16. (U) U.S.-Japan Reg Reform Talks Commence

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An inter-agency team arrived from Washington to meet with their GOJ counterparts to launch the sixth round of talks on Regulatory Reform the week of January 22. They are discussing each government's recommendations, which were

exchanged last month between Deputy Foreign Minister Yabunaka and Deputy U.S. Trade Representative Bhatia.

The recommendations are covered in working groups on Telecommunications, Cross Sectoral, Information Technology, Financial Services, and MedPharm and can be found on the U.S. Embassy website.

17. (U) Financial Services Working Group Meets in Tokyo  
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Treasury DAS Mark Sobel led a delegation of U.S. financial services regulators to the annual Financial Services Working Group on January 22.

Participants included: the Securities and Exchange Commission, the Federal Reserve Bank, the Office of the Comptroller of the Currency, the Commodity Futures Trading Commission, and the Federal Deposit Insurance Corporation.

Interfacing primarily with the Financial Services Agency, much of the talk centered on banking and financial service regulatory matters, with a series of regulator-to-regulator meetings subsequent to the main discussion.

Given Financial Services Minister Yamamoto's recent exhortations for Tokyo to become an international financial center, Japan's financial regulatory regime will be subject to frequent assessment leading up to next year's talks.

18. (U) FTAs: Private Sector Interest: Joint Statement Calls for EPA Discussion  
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The U.S. Business Roundtable and the Japan Business Federation (Keidanren) issued a joint statement on January 19 urging both governments to begin discussions toward a framework of negotiations for an economic partnership agreement as soon as possible.

In the joint statement, the two organizations agree that the United States and Japan already enjoy a strong, interdependent relationship, but that an EPA would further remove inefficient regulations that impede economic growth in certain areas, such as liberalization in trade in services, investment and protection of intellectual property rights.

The statement has so far received scant attention in the Japanese press.

19. (U) Japan-Swiss Report Calling for FTA Issued  
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TOKYO 00000385 003 OF 007

The 35-page Report of the Joint Governmental Study Group for Strengthening Economic Relations between Japan and Switzerland is now on the MOFA website in English.

(Texts in English of agreements relating to FTAs with other countries can also be found on this site.)

The Study Group recommends launching negotiations for a comprehensive FTA/EPA between Japan and Switzerland "as soon as possible."

If reached, the report notes, the FTA/EPA would be the first of its kind between Japan and a European country.

Topics covered in the report include: trade in goods; trade in services; investment; government procurement; IPR; movement of natural persons; competition policy; improvement of business environment; cooperation; institutional issues and dispute settlement; and a simulation study on the economic effects of an EPA.

The report's appendix has a lengthy list of the Japanese and

Swiss officials involved in the Study Group.

For the uninitiated, the agricultural section makes for a fascinating read.

¶10. (SBU) Reform: CPRR Members Hopeful; Abe's Press Treatment  
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CPRR chairman Takao Kusakari and council members Keiko Honda and Tatsuo Hatta conveyed their disappointment to EMIN during a January 24 meeting on the relative lack of progress on reform recommendations in the council's December 2006 final report (see Tokyo 7180 on December 2006 final report). The trio expressed hope, however, that the infusion of new members and a change of Ministers responsible for the CPRR would breathe new life into the reform process.

(Note: Ms. Honda comments from two weeks ago were distinctly negative about the reform process, see Tokyo 0154)

They stated that Prime Minister Abe is a gifted politician but is not being treated fairly by the press and speculated as to why.

We will report more on this in an upcoming cable.

¶11. (SBU) House of Councilors' Member Hayashi on Reform and Leadership  
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In a January 24 meeting with EMIN, fourth generation politician Yoshimasa Hayashi expounded upon efforts to consolidate Japan's 47 prefectures into 14 administrative blocks, stating that, if achieved, it would be the biggest reform movement since the Meiji era.

The consolidation, which will begin this year with Hokkaido as a test case, would push powers currently held by the central government down to the prefectural level and would have wide-ranging implications, including necessitating to re-organize government ministries.

Hayashi also stated that Abe has a more orthodox negotiating style than his predecessor, Junichiro Koizumi, and is perhaps finding it difficult to get out from under that shadow.

We will report more on this in an upcoming cable.

¶12. (U) Japanese M&A Surge; Most Domestic Deals  
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There were a record high of 2,775 M&A transactions involving Japanese companies in 2006 worth 15.2 trillion yen, up 27.1 percent from the previous year, according to M&A consulting firm RECOF.

RECOF noted this growth showed the aggressiveness of business managers against the backdrop of satisfactory business performance and the rise in stock prices. This value of transactions was the second highest on record after the 18 trillion yen worth of deals in 2001 when several major Japanese banks were reorganized.

An analysis of the figures by direction shows the vast majority -- 2,175 -- were purely domestic deals ("IN-IN"). The rest of the breakdown was: purchases of foreign companies by Japanese companies ("IN-OUT"): 412 transactions; purchases of Japanese companies by foreign companies ("OUT-IN"): 171 transactions and; purchases by Japanese overseas subsidiaries of other overseas firms ("OUT-OUT"): 17 deals.

TOKYO 00000385 004 OF 007

Despite the increase in total M&A transactions, inward M&As showed a slight year-on-year decline.

The top three deals by value were Japan Tobacco's purchase of the British firm, Gallaher (2,253 billion yen) Softbank's purchase of

the mobile phone operator Vodafone's Japanese operations (1,917 billion yen, combination LBO/TOB), and Toshiba and Ishikawajima Harima's purchase of Westinghouse (621 billion yen). Among top 20 deals, 12 were outward investment and the other 8 were domestic transactions.

#### 13. (SBU) Ag: U.S. Beef Imports to Japan Remain Low -----

After the partial lifting of an import ban last summer, Japanese consumers are not coming back to U.S. beef.

According to a January 25 Nikkei article, trade statistics show import levels at only 10 percent of pre-ban levels.

In November 2006, 1,600 tons were imported, compared to 20,000 tons before the discovery of a BSE infected cow in the United States in 2003 prompted GOJ authorities to halt trade.

A MOFA official told us it does not help that Japan's media, including NHK, continue to produce alarming stories about the BSE problem.

According to Nikkei, "safety-sensitive" housewives have switched to Australian products and far fewer Japanese retailers now sell U.S. beef.

The article did not note that a major part of the problem is on the supply side -- Japan's continued ban on beef from cows over 20 months old has severely constricted U.S. efforts to export to Japan.

#### 14. (SBU) New Barriers to Trade Being Erected -----

At a meeting at the Agriculture Ministry (MAFF) on January 24, an inter-agency delegation from USTR, USDA, the U.S. Patent Office and the Embassy raised concerns about a new labeling system the Japanese are developing which could make impossible all imports of wagyu beef. (To read about the background of wagyu, click [here](#).)

The Japanese are taking steps to ban imports at a time when the United States -- saddled with restraints on U.S. beef exports over the BSE problem -- is blocked from shipping wagyu to Japan anyway.

The Embassy is preparing points (attached below) to submit during a public comment period that concludes on February 10.

The labeling initiative is a troubling precedent that suggests Japan is willing to move beyond tariff and phytosanitary barriers to restrict agricultural trade.

The MAFF officials said that the new guidelines were "voluntary." They were put forward by a study group over which the Ministry has no control.

The U.S. delegation countered that the guidelines in question were drafted by MAFF before being taken up by the study group at MAFF's request.

The Embassy's FAS section heard separately that MAFF's original intention was to put out the wagyu guidelines as mandatory regulations, but when Japan's Fair Trade Commission balked, they were recast as "voluntary."

A key concern the United States has is whether authorities are planning other similar guidelines on products such as Japonica rice. Perhaps recognizing the larger WTO/trade implications of the broader issue, MAFF deflected this line of questioning, with one official indicating they were meeting "only to discuss wagyu."

The MAFF officials said that the guidelines could be changed after new information is introduced. If foreign producers could prove that their product meets the strict domestic standards of wagyu producers, one official asserted, the born-and-raised-in-Japan requirement could be reconsidered.

115. (U) Energy: Joint Seminar Examines Asia Pacific Energy Security  
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MOFA and METI co-sponsored an Energy Security Seminar on January 19 with guest speakers from the International Energy Agency (IEA), the Canadian and New Zealand Embassies, the Australian Department of Industry, Tourism and Resources, the Korean Ministry of

TOKYO 00000385 005 OF 007

Commerce, Industry and Energy, and Singapore's ReCAAP Information Sharing Centre, which looks at piracy and armed robbery in Asia. Discussions ranged from energy security policy to energy efficiency to emergency response in the Asia Pacific region.

Ambassador William Ramsay of IEA defined energy security as clean, affordable, reliable energy, while New Zealand's Bruce McCallum argued that definitions of energy security often have varying emphases on reliability, market volatility, adequacy of supply and environmental trade-offs.

Ramsay addressed concerns over China and India participating in IEA responses to emergencies such as Hurricanes Katrina and Rita, highlighting the IEA's ongoing efforts to help the two countries understand coordination efforts and impact. He also raised the need to stockpile natural gas similar to the way oil is now stockpiled.

Participants generally agreed that energy security is a growing concern requiring increased investment and cooperation. The Asia Pacific will need to increase its energy diversification and efficiency as well as improve its data sharing. Collectively, the region and the world can mitigate disruptions to energy supply but without coordination the region is vulnerable.

116. (U) Business: Keidanren Leadership Reshuffle  
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The Japan Business Federation (Nippon Keidanren) has announced the new makeup of its board to take effect after its general meeting in late May. Seven of the current 15 Vice-Chairmen will be replaced.

The seven incoming Vice-Chairmen are:

Mikio Sasaki (Chairman, Mitsubishi Corp);  
Kunio Nakamura (Chairman, Matsushita Electric Industrial);  
Tomijiro Morita (Chairman, Dai-Ichi Mutual Life Insurance);  
Shoei Utsuda (CEO, Mitsui & Co.);  
Sadayuki Sakakibara (CEO, Toray Industrial);  
Terunobu Maeda (CEO, Mizuho Financial Group), and;  
Kazuo Furukawa (CEO, Hitachi).

The remaining eight Vice-Chairmen reappointed for another term are:

Hiromasa Yonekura (President, Sumitomo Chemical);  
Takao Kusakari (Chairman, Nippon Yusen (NYK Line));  
Tsunehisa Katsumata (President, Tokyo Electric Power);

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Fujio Cho, Chairman (Toyota Motor);  
Tadashi Okamura (Chairman, Toshiba) (Former Keidanren chair);  
Akio Mimura (President, Nippon Steel);  
Watari Fumiaki (Chairman, Nippon Oil), and;  
Kunio Egashira (Chairman, Ajinomoto).

117. (SBU) Osaka Prefecture to Provide Japan's First SME Tax Incentives  
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In 2007, Osaka Prefecture will introduce a 1.6 billion yen (13.3 million USD) tax incentive program targeted at investment by small and medium enterprises (SMEs) with capital of less than 10 million yen (83,000 USD).

The prefecture will reduce corporate taxes by 20 percent for companies making a capital investment of more than \$13,000 in



Osaka.

Although many local governments, including Osaka, have provided subsidies and loans for SMEs, this is reportedly the first tax exemption program in the country.

Takumi Hirai, senior industrial researcher with the prefecture, commented that the advantage of attracting new businesses and halting the flight of businesses already in Osaka outweighs the estimated reduction in short term corporate tax revenues from the plan.

Approximately one third of Osaka's 3.3 billion USD tax revenue in FY2005 came from businesses.

Hirai speculated that the real impact of the plan would be hard to predict because businesses with a deficit already do not pay any corporate tax to the prefecture.

18. (U) Civair: Israeli FM Discussed Tel Aviv Tokyo Flights  
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Amidst front burner Middle East issues, Israeli Foreign Minister Tzipi Livni also discussed arranging direct flights between Tel Aviv and Tokyo during her January 17-18 trip to Japan, according to the Israeli Ministry of Foreign Affairs' website. For more on her trip see Tokyo 0356.

TOKYO 00000385 006 OF 007

19. (U) MLIT's Airports Discussion Group Members Express Need for More Meetings  
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According to a January 22 Aviation Daily Japan article, the Airports Discussion Group 4th meeting held on January 19 concluded that further discussion was needed of the "internationalization" of Haneda airport, 24-hour operation at Japan's three international airports, and the operations of fully privatized international airports.

Members of the group reportedly requested to Japan Civil Aviation Bureau that other related parties, such as representatives from other ministries and the tourism and cargo service industries, which had not been invited to previous meetings, should be invited to make presentations.

In response, Mr. Hisayasu Suzuki, Director-General of Civil Aviation Bureau at Ministry of Land, Infrastructure and Transport (MLIT), hinted at the possibility of extending the number of meetings before the final report is to be produced. It is currently expected by the end of March.

The Airports Discussion Group has held a series of meeting since October 24, 2006 with the goal of producing a report on "concept of Japan's international airport in future" by end of March 2007. In the previous meetings, Japanese airport companies, Japanese airlines and municipal governments related to international airports made presentations.

The final report is scheduled to be submitted to Aviation Subcommittee, which sits under the Transportation policy committee in MLIT, to be taken up for the budgetary request for implementation in 2008.

The USG had requested transparency of those discussions for all stakeholders in the recent bilateral regulatory reform recommendations, but foreign airlines' association has not been invited for those hearings so far.

20. (SBU) New Study Group to Promote KIX U.S. Routes  
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Kansai International Airport Co., Ltd. (KIAC), the Kansai Economic Federation, the Osaka Chamber of Commerce and Industry, the Japan Association of Travel Agents, and Osaka Prefecture will

establish a study group for increasing KIX U.S. routes. ConGen Econoff will join the group as an observer.

Those involved are seriously concerned about the precipitous drop in flights between KIX and the U.S. KIX used to have six carriers operating 63 flights a week to six cities on the U.S. mainland. Now there are only 14 flights to two cities, United's San Francisco route and Northwest's Detroit route. Japan Airlines has decided to discontinue all flights to the mainland United States after the summer of 2006.

In 2006, the number of passengers traveling between KIX and U.S. cities is almost half of the 1999 level.

The study group understands that carriers are concentrating on Narita for improved efficiency given rising fuel and security costs and the dearth of KIX business passengers. Therefore, the study group will target both U.S. and Japanese carriers as well as the local business customer base.

The GOJ stipulated that KIX reach 130,000 flights in 2007 in order to receive national budget funding for its 2nd runway, which is scheduled to be opened in August 2007.

More China routes have improved KIX's bottom line, but these are being offset by the reduction in flights to North America.

121. (U) Regional Airports in Western Japan Focus on Profit and Shed Low-Demand Routes  
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In revised new flight schedule starting April 2007, KIX will increase its Sapporo, Fukuoka, and Kochi routes and discontinue flights to Miyazaki. Kobe Airport will increase flights to Haneda, Sapporo, and Naha, and cut Sendai, Kumamoto, Niigata, and Kagoshima. The total number of domestic flights will remain unchanged, but all airports are focusing on maximizing more profitable routes.

On the other hand, Itami Airport, despite having a higher load factor than a similar route from KIX, is cutting back on its Sapporo route to only one flight a day. Starting in April, Itami will be under an MLIT ceiling of 370 flights (200 jet flights) per day.

Airlines use jet flights for long hauls to Hokkaido and Okinawa,

TOKYO 00000385 007 OF 007

so the MLIT policy is forcing airlines to sacrifice these high demand flights.

Local business travelers and tourists still like the convenience of Itami and are reportedly unhappy about the central government's new policy.

122. (U) Basic Industries: Japanese Diemakers Look to Expand Abroad  
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Nikkei's fifth annual survey of Japanese die and mold makers shows they are seeking to increase overseas operations as their customers globalize, according to the Nikkei Weekly of January 122.

Nikkei notes that Japanese manufactures' "state-of-the-art dies and molds have underpinned the overall competitiveness of Japanese industry."

Nikkei reports that there are some 7,000 diemakers employing approximately 100,000 workers in Japan. Declines in output recently have been reversed due to a rise in exports.

The Ministry of Economy, Trade and Industry supports the industry as it is considered to have important technologies that are basic to manufacturing operations.

According to Nikkei's industry sources, high-precision dies that



have error margins of only 10-20 microns are only made in Japan.

Japanese diemakers are facing greater competition from foreign producers of dies and molds as computer-aided design and quality machine tools have spread. While going abroad, Japanese firms worry about technology loss and quality issues, Nikkei notes.

SCHIEFFER